No. 12302

In the United States Court of Appeals for the Ninth Circuit

CAPITAL SERVICE, INC., A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
ROBERT N. ANDERSON,
S. DEE HANSON,
Special Assistants to the Attorney General.

INDEX

CITATIONS

Cases—Continued

Statutes:

Miscellaneous:

In the United States Court of Appeals for the Ninth Circuit

No. 12302

CAPITAL SERVICE, INC., A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 391-410) are not officially reported.

JURISDICTION

The petition for review herein (R. 412-414) involves federal corporate income tax for the year 1943 (R. 392, 411). On January 30, 1947, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency for that year in the total amount of $7,358.10. (R. 9-16.) Within 90 days thereafter, on April 17, 1947, the taxpayer filed a petition and later on May 5, 1948, an amended petition with the Tax Court for redetermination of that deficiency, under the provisions of Section

272 of the Internal Revenue Code. (R. 4-16, 21-26.) The decision of the Tax Court sustaining the deficiency was entered May 12, 1949. (R. 411.) The case is brought to this Court by the taxpayer's petition for review filed June 15, 1949 [1] (R. 412-414), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the taxpayer sustained a net operating loss in 1942 which it was entitled to carry forward and deduct from gross income for the taxable year 1943, under the provisions of Section 122 (a) and (b)(2) of the Internal Revenue Code.

The answer depends on whether the taxpayer sustained deductible losses in 1942 in the amount of $1,300 on capital stock and in the amount of $31,567.81 on a debt which allegedly became worthless during that year, within the meaning of Section 23 (f) and (k), respectively, of the Internal Revenue Code, resulting in a net operating loss for 1942.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are printed in the Appendix, *infra*.

STATEMENT

The facts were found by the Tax Court upon the oral testimony, the documentary evidence, and the partially stipulated facts, as follows: [2] (R. 393-406):

The taxpayer is a California corporation, formed April 23, 1936. For the calendar years 1942 and 1943

---

[1] The record indicating that the taxpayer's petition for review was filed on June 19, 1949 (R. 414), is apparently in error for the docket entries and the taxpayer show that it was filed with the Tax Court on June 15, 1949 (R. 4; Pet. Br. 1).

[2] The findings of fact pertaining to another issue (R. 393-394), decided against the taxpayer (R. 410) and not appealed (R. 412-414; Pet. Br. 5), have been omitted.

it filed consolidated returns with the Collector of Internal Revenue for the Sixth District of California. The taxpayer's subsidiary, A. & W. Baking Company (name changed to Danish Maid Bakery), joined in filing the consolidated returns. (R. 393.)

In the 1942 consolidated return the subsidiary had a net income of $5,685.22, exclusive of a net operating loss deduction; the taxpayer reported a net operating loss of $27,492.98 for 1942. In arriving at that loss the taxpayer deducted, upon the grounds of worthlessness: (1) an indebtedness of $31,567.81 owed to it by Central California Utilities Corporation; and (2) $1,300 representing the adjusted basis to it of 1,050 shares of stock of that corporation. In the notice of deficiency herein the Commissioner disallowed the deductions, totaling $32,867.81, and determined that, with $4,103.53 of deductions not claimed by the taxpayer but allowed by the Commissioner, the taxpayer had an adjusted net income for 1942 of $1,271.30, excluding net operating loss deductions. (R. 394.)

None of the income reported on the 1943 consolidated return of the taxpayer and its subsidiary, in the amount of $122,566.32, represented income of the taxpayer. Adjustments by the Commissioner for 1943 resulted in his determination that the consolidated net income adjusted for 1943 was $25,196.55 instead of the net loss of $23,012.20 reported on the consolidated return. (R. 394.)

Central California Utilities Corporation, hereinafter referred to as Central, is a California corporation, formed August 3, 1936, for the purpose of taking over the assets and liabilities of the Inland Public Service Company, hereinafter referred to as Inland. Continuously after some time in 1933, and prior to the formation of Central in 1936, Inland owned all the issued and outstanding stock of Gas Fuel Service Company

and Kettleman Lakeview Oil and Gas Company, Ltd., hereinafter referred to as Gas Fuel and Kettleman, respectively. The primary function of Kettleman was to own producing wells and leases upon which such wells could be drilled, and to produce gas for sale. The primary purpose of Gas Fuel was to buy gas from Kettleman and others and distribute it for sale to customers in Kings and Fresno Counties, California. (R. 394-395.)

All of the issued and outstanding shares of Gas Fuel and Kettleman were acquired by Central from Inland on or about September 5, 1936. At all times material hereto such shares were the sole assets owned by Central. The certificate of dissolution of Inland was filed with the California Secretary of State on March 10, 1937. (R. 395.)

The early history of Gas Fuel and Kettleman is partially revealed by Decision 26178 of the Railroad Commission of California, 38 C.R.C. 875. It appears therein that on January 23, 1933, Gas Fuel asked the Commission for an order certifying that "public convenience and necessity require and will require the construction and operation of a natural gas transmission and distribution system for the service of natural gas to the agricultural power users in Fresno and Kings Counties and to exercise franchise rights which it contemplates acquiring from said counties." Three other companies resisted Gas Fuel's application and a series of public hearings were held by the Commission. The Commission's decision shows that in or about 1930 the organizers of Gas Fuel owned approximately 1,500 acres of potential oil and gas lands in the Dudley Ridge area of Kings County; that these owners organized Kettleman for the development of their properties; that at the time of the hearings (April and May, 1933) three producing gas wells were on the properties, which witnesses

estimated had a daily production of 20,000,000 cubic feet over a period of 20 years; that Gas Fuel sold under contract to Pacific Gas and Electric Company, hereinafter referred to as Pacific, 1,000,000 cubic feet of gas per day and small quantities of gas to others in the vicinity of the wells; that a survey of farmers of Kings and Fresno Counties, made to secure new outlets for its surplus gas production, indicated approximately 81 potential gas users who would secure an over-all saving of one-third to one-half of their present costs; that Gas Fuel proposed to sell gas at 16 cents per 1,000 cubic feet in Fresno County; that such rates were much lower than the rates of the opposing companies; that Gas Fuel would be farmer owned, controlled and managed; and that the estimated cost of installing its proposed transmission and distribution lines was approximately $680,861. The Commission granted Gas Fuel's request and denied the requests of the resisting companies on July 21, 1933. (R. 395-396.)

During May 1933, Kings and Fresno Counties each granted Gas Fuel a franchise by ordinances, which ordinances have never been repealed. Each franchise gave Gas Fuel the non-exclusive right and privilege of using the County's streets, highways and alleys for the purpose of laying and maintaining a gas distribution line. Each franchise required work to commence thereunder within four months or the franchise "shall be declared forfeit." Each franchise required Gas Fuel, or its assigns, to pay the County after the fifth year, 2% of the gross annual receipts arising from the use of the franchise. (R. 396-397.)

Under date of August 28, 1933, the Railroad Commission of the State of California granted Gas Fuel a certificate of public convenience and necessity (R. 397)—

> * * * authorizing said utility to exercise the rights and privileges granted to it under Ordinance

> No. 151 of the County of Kings and Ordinance 290 of the County of Fresno, provided that the Commission may hereafter, by appropriate proceedings and orders, revoke or limit, as to territory not then served by Gas Fuel Service Company, or its successors in interest, the authority herein granted.

Following receipt of its certificate Gas Fuel laid approximately 32 miles of gas line in Kings County. Thereafter it distributed gas procured from Kettleman to its customers. Early in 1935 Kettleman's only gas well blew out depriving Gas Fuel of its gas supply. At the time Gas Fuel lost its gas supply it was serving 10 or 12 customers. (R. 397.)

By December 31, 1935, Inland was in financial difficulties. The combined book assets of Inland, Gas Fuel and Kettleman as of that date showed current assets of $1,800 and current liabilities in excess of $60,000. Other assets of the companies were valued on their books at December 31, 1935, as follows: pipe lines, $44,740.78; meters and regulators, $354.56; general office equipment, $463.98; miscellaneous equipment, $407.55; lands and leases, $901,112.50; and wells, $200,000. Subsequently, and as of December 31, 1935, the book values of lands, leases and wells were eliminated by quitclaims and abandonment. (R. 398.)

Late in 1935 or early in 1936 one of the promoters of Inland approached Ralph W. Moore seeking financial aid. Moore investigated Inland's condition and its prospects. His investigations convinced him that if Inland was reorganized and financed, it could become a very profitable operation. He found that Fresno and Kings Counties offered a practically unlimited market and that ample gas supplies appeared to be available within the area served by Gas Fuel or in nearby areas. He located three gas wells that could be purchased or leased, which, on the basis of prior production, would

provide an ample supply of gas. Two of the wells had been plugged with cement and one had been capped. Oil companies operating in or near Kings and Fresno Counties had had to shut down their gas wells because Pacific had ceased purchasing gas in the area, and Moore considered the shut down wells as a further source of supply. He became quite optimistic over Gas Fuel's prospects and succeeded in getting G. Brashears and Company, a Los Angeles firm engaged in selling securities, to put up $20,000 to enable Inland to resume operations. G. Brashears and Company will hereinafter be referred to as Brashears. (R. 398-399.)

Moore and Brashears agreed that, after Inland's business was restored to an operating basis, a new company (Central) would be organized to acquire Inland's assets and liabilities. The plan of reorganization contemplated that the taxpayer would advance the money needed for the Inland project. Such sums as Moore and Brashears advanced temporarily were repaid by the taxpayer. Under the plan of reorganization Moore and Brashears were to have a 25% interest and a 75% interest, respectively, in the promotion stock, Inland stockholders were to receive stock of the new company (Central) and the remaining shares of the authorized issue were to be held for possible future sale to the public. The promotional stock represented over 50% of the shares entitled to vote. Such stock had no cost basis in the taxpayer's hands. Since some time in 1936 the taxpayer has owned 1,050 shares of Central's capital stock, which has an adjusted cost basis of $1,300. (R. 399.)

After Central was organized and during 1936 the taxpayer made cash advances to or for its benefit totaling $25,561.71, which included sums advanced by Moore and Brashears. Credits to this account during 1936 totaled $5,311.71, leaving a balance due the taxpayer

on January 1, 1937, of $20,250. During 1937 additional cash advances were made to Central by the taxpayer in the aggregate amount of $14,000. Except for a $50 advance on January 24, 1938, no further loans were made by the taxpayer to Central. The amount of Central's indebtedness to the taxpayer at January 31, 1938, was $34,300. Credits to the account of $1,900 on June 3, 1938, and $832.19 on April 30, 1940, reduced the indebtedness to $31,567.81, as of April 30, 1940, which was the amount finally charged off the taxpayer's books as a loss on December 31, 1942. (R. 399-400.)

The funds advanced by the taxpayer to Central enabled its subsidiary, Gas Fuel, to resume operation of its gas distributing system. A portion of the funds were used by Kettleman in an unsuccessful attempt to bring in its own gas wells, after which it obtained a supply of gas from a nearby capped gas well. This supply was ample for the limited number of customers then being served by Gas Fuel. On or about May 29, 1937, this well was destroyed by geophysical tests conducted by Shell Oil Company in nearby territory. On or about July 21, 1937, Gas Fuel contracted for a supply of gas from Southern California Gas Company, hereinafter referred to as Southern. Gas Fuel's contract with Southern was terminated on or about November 11, 1937, because Gas Fuel failed to pay for the gas. At that time Gas Fuel's gas bills exceeded $1,100 and its bills were unpaid since the middle of August. At no time thereafter did Gas Fuel operate its gas distribution system. At the time Gas Fuel ceased operating its gas system it had about 10 customers. (R. 400-401.)

In November, 1937, Gas Fuel applied to the Railroad Commission of California for permission to temporarily discontinue its service in Kings County. Permission was granted by the Commission on January 3, 1938. In its opinion the Commission pointed out that the tre-

mendous line losses sustained by Gas Fuel [3] "is entirely inexcusable and indicates gross inefficiency on the part of the applicant in the maintenance of its facilities." Gas Fuel was ordered to complete repairs to its lines and facilities as soon as possible and to file progress reports with the Commission at the end of each 30 days. Gas Fuel estimated that the repairs could be made in from 60 to 120 days at a cost of $2,000. (R. 401.)

Gas Fuel notified Shell Oil Company, hereinafter referred to as Shell, by letter dated June 2, 1937, of the destruction of its gas supply by the acts of the latter's employees and demanded satisfaction from Shell. The extent and the nature of the negotiations with Shell are undisclosed but the taxpayer's account with Central shows a credit of $1,900 on the latter's indebtedness under date of June 3, 1938, which represented an amount received in settlement of Gas Fuel's controversy with Shell. (R. 401.)

No attempt was made by Gas Fuel to repair its gas distribution system. Floods in 1938 further damaged the lines with the result that in 1939 Gas Fuel sold the pipe and all of its other physical assets. It sold its pipe lines for about $2,500, the purchaser agreeing to pay Gas Fuel's taxes and turn over the receipted tax bill with his check for the difference. Central's account with the taxpayer shows that the difference amounted to $832.19, which was credited on the taxpayer's books, April 30, 1940. Gas Fuel turned over its regulators, meters and a Chevrolet truck to one of its employees in satisfaction of unpaid wages. After disposing of these assets, Gas Fuel's sole remaining asset was its certificate of public convenience and necessity. (R. 401-402.)

[3] Gas Fuel showed the Commission that it purchased 2,614,000 cubic feet of gas from Southern California Gas Company during October, 1937, while sales to its customers totaled 422,341 cubic feet, the difference being attributed to line losses.

By December 1, 1939, Kettleman was without property of any kind whatsoever and never thereafter acquired, owned or held any property. (R. 402.)

On or about January 6, 1940, the corporate charters of Central, Gas Fuel and Kettleman were suspended by the Secretary of State of California for failure to pay the State franchise tax. At all times thereafter these charters were suspended. (R. 402.)

Negotiations looking forward to securing a supply of gas for Gas Fuel were conducted by Moore with various individuals and oil companies during 1937 and thereafter. Moore's early negotiations were based upon the purchaser supplying the gas only; his later negotiations were based upon the purchaser supplying the gas and a new pipe line system for distribution. By December 31, 1940, all of these negotiations had proved fruitless. On March 25, 1941, and in August, 1941, he wrote letters to two separate individuals seeking unsucessfully to interest them, their associates, or their clients in the project. (R. 402-403.)

During the interim between January 3, 1938 (when Gas Fuel was permitted temporarily to suspend its service), and October 6, 1942, the Railroad Commission repeatedly called upon Gas Fuel to advise it when Gas Fuel would resume service. Gas Fuel or Central gave the Commission various reasons for its failure to resume service to its customers. On October 8, 1938, the Commission was advised that the flooded condition of the land indicated that it would be well into the year 1939 before flood waters receded to a point where customers would require resumption of service for water pumping. In August, 1939, and in June, 1940, the Commission was advised that there was still no demand for gas for water-pumping purposes. On March 17, 1941, the Commission advised Central that if it intended to abandon service in its territory a formal application to

the Commission should be made. On March 25, 1941, Central replied that negotiations were under way looking forward to possible resumption of service, but that if the negotiations were not successfully concluded the abandonment of the "franchise" held by Gas Fuel would be taken up with the Commission. From October 15, 1941, to May 22, 1942, inclusive, the Railroad Commission wrote Central at least five letters requesting information about the status of Gas Fuel and when service to its customers would be resumed. On June 9, 1942, the Commission was advised that Gas Fuel "is no longer operating, having been inactive for the past three years." By order dated October 6, 1942, the Railroad Commission revoked Gas Fuel's certificate and referred in its opinion to Gas Fuel's letter of June 9, 1942, as one of the reasons for the revocation. (R. 403-404.)

In a letter to Moore on November 22, 1940, the Internal Revenue Agent in charge in Los Angeles stated that certain stockholders of Central had claimed that their stock became worthless in 1939. Moore was requested to "furnish information covering any event which in your opinion rendered the stock worthless. It is noted that the balance sheet of December 31, 1939 shows stock in subsidiaries, $1,124,507.49." In his reply, dated December 2, 1940, Moore stated that the stock value of $1,124,507.49 represented the book value of Gas Fuel and Kettleman, wholly owned subsidiaries; that Central had no assets other than the stock of its subsidiaries; that the subsidiaries had no assets of any nature except the "questionable value of its certificate of public necessity"; that the value thereof was commensurate with whatever profit Gas Fuel "might be able to earn from its operations, all of which now are suspended," and that it was his personal opinion as principal officer of the three corporations "that their

stock became practically worthless in the early part of 1939." (R. 404.)

The income tax returns of Kettleman, Gas Fuel, Central and taxpayer for the taxable years of 1936 to 1939, inclusive, show losses for each taxable year by each corporation.[4] The income tax returns for 1940 of Kettleman, Gas Fuel and Central each contain the following statement: "Corporation dormant for past two years. No transactions of any nature in 1940. Corporate franchise cancelled for non-payment of state franchise in 1938." (R. 404-405.) The taxpayer's income tax returns for 1940 to 1943, inclusive, show losses as follows (R. 405):

1940	$7,082.40
1941	30.50
1942*	49,198.79
1943*	23,012.20

* Consolidated return filed with A. & W. Baking Company.

During 1937 the taxpayer invested in two other business enterprises in addition to Central. These investments were in Timm Aircraft Company and Ful-Ton Truck Company. The taxpayer disposed of its investment in Timm Aircraft in 1942 at a profit of $5,650. Its investment in Ful-Ton Truck Company evolved eventually into its wholly-owned subsidiary, the A. & W. Bakery Company, a wholesale bakery. The taxpayer continued to finance the Aircraft Company and the Bakery Company after it ceased financing Central. (R. 405.)

The indebtedness of Central to the taxpayer and the stock owned by the taxpayer in Central became worthless prior to January 1, 1942. (R. 406.)

[4] No tax return for Kettleman for 1937 was placed in evidence.

On the basis of the foregoing facts the Tax Court, affirming the Commissioner's determination (R. 9-16), held that the indebtedness and stock of the Central California Utilities Corporation owed to and owned by the taxpayer, respectively, became worthless prior to 1942 and that therefore the taxpayer is not entitled to the net operating loss carry-over based thereon claimed as a deduction for the taxable year 1943 (R. 406-410). The Tax Court thereupon entered its decision accordingly (R. 411), from which the taxpayer petitioned this Court for review (R. 412).

SUMMARY OF ARGUMENT

The Tax Court correctly found that the taxpayer suffered the claimed bad debt and stock losses in question prior to 1942, and therefore they may not be carried forward and deducted as net operating losses for the taxable year 1943. Since the ultimate question of worthlessness is clearly one of fact, the Tax Court's finding that the taxpayer failed to prove worthlessness of the two items in question in the critical year involved is conclusive upon review if there is substantial evidence to support it. The Tax Court, upon carefully weighing all the evidence, found a series of identifiable events specifically showing absence of either intrinsic or potential value and therefore complete worthlessness of both items before or during 1941, and the facts, as found, fully sustain its ultimate finding that they became worthless prior to January 1, 1942. Since the taxpayer has failed to prove anything to the contrary, the Tax Court's finding and decision should be affirmed upon review.

ARGUMENT

The Tax Court Correctly Found That the Taxpayer Suffered the Claimed Bad Debt and Stock Losses in Question Prior to 1942, and Therefore They May Not Be Carried Forward and Deducted as Net Operating Losses for the Taxable Year 1943

The sole question presented is whether the taxpayer sustained a net operating loss during the year 1942, as claimed. If it did, it is entitled to carry over and deduct such amount as a net operating loss for the taxable year 1943. Section 122 (a) and (b) (2) of the Internal Revenue Code, as amended (Appendix, *infra*). Whether or not the taxpayer actually suffered such loss in 1942 depends on whether the indebtedness and the shares of stock of Central here in question became worthless in that year. Such items comprised funds advanced by the taxpayer to Central in the total sum of $30,567.81 during 1936-1938, and the adjusted cost basis of $1,300 to the taxpayer of 1,050 shares of Central's stock acquired by it in 1936. (R. 394, 409.) The Commissioner determined that the amounts in question did not constitute proper deductions for loss and bad debt for the year 1942, under the provisions of Section 23 of the Internal Revenue Code (Appendix, *infra*), and that therefore the taxpayer had net income instead of a net operating loss carry-over for that year. (R. 11-16, 393, 394.) The Tax Court sustained his determination on the ground that the two items in question had become worthless before January 1, 1942. (R. 406-410.) The taxpayer contends that this was error because the decision of the Tax Court is not supported by any evidence, and is not in harmony with the correct principles of law applicable in such cases. (Br. 6, 19-49.)

Since the statute allows as deductions, in computing corporate net income, "losses sustained during the taxable year" with respect to securities which become

worthless during the taxable year, and "Debts which become worthless within the taxable year" (Sec. 23 (f) and (k)(1), respectively), the same factual considerations, criteria and legal principles apply for determining the year for taking deductions for stock losses and bad debts, that is, the year during which they actually become worthless. *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 225-226 (C. A. 9th); *Jones* v. *Commissioner,* 103, F. 2d 681, 684-685 (C. A. 9th); *Belser* v. *Commissioner,* 174 F. 2d 386, 390 (C. A. 2d), certiorari denied, 338 U. S. 893; *Atlantic Coast Line Railroad Co.* v. *Commissioner,* 4 T. C. 140, 155-156. Consequently, we discuss both items together.

There is no controversy that the two items in question were actually worthless *in* 1942, the issue being the specific year during which identifiable events occurred effecting worthlessness. It is our position that worthlessness of the two items and consequently the losses occurred prior to 1942, and that therefore the taxpayer is not entitled to the claimed net operating loss carry-over deduction for 1943. The taxpayer claims, however, that the identifiable event causing the two items to become worthless occurred during the year 1942, a contention it must prove, of course, in order to prevail. *Helvering* v. *Gowran,* 302 U. S. 238, 245; *Hirsch* v. *Commissioner,* 124 F. 2d 24, 28 (C. A. 9th); *Belser* v. *Commissioner,* 174 F. 2d 386, 389 (C. A. 4th), certiorari denied, 338 U. S. 893; *Gowen* v. *Commissioner,* 65 F. 2d 923, 924 (C. A. 6th), certiorari denied, 290 U. S. 687; *Dunbar* v. *Commissioner,* 119 F. 2d 367 (C. A. 7th); *Morton* v. *Commissioner,* 112 F. 2d 320 (C. A. 7th). Hence, it must meet the burden of showing the Commissioner's determination wrong by establishing that the two items in question had actual or at least potential value at the close of the preceding year (1941), and therefore in 1942. *San Joaquin Brick Co.* v. *Com-*

missioner, supra, pp. 225-226; *Dunbar* v. *Commissioner, supra.* Since the taxpayer does not claim that they had a present intrinsic value, the question is narrowed to a determination as to whether they had any "*potential* value at the close of the preceding year." (Pet. Br. 22, 24-39, 50-51.). Moreover, inasmuch as the ultimate question of worthlessness is purely a question of fact (Pet. Br. 19), the finding that the taxpayer failed to prove worthlessness in the critical year involved is conclusive upon review where, as here, there is substantial evidence to support it. *Boehm* v. *Commissioner,* 326 U. S. 287; *Wilmington Co.* v. *Helvering,* 316 U. S. 164; *Helvering* v. *Kehoe,* 309 U. S. 277, 279; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 294; *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S. 37; *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 225 (C. A. 9th); *Hirsch* v. *Commissioner,* 124 F. 2d 24 (C. A. 9th); *Commissioner* v. *Laughton,* 113 F. 2d 103, 105 (C. A. 9th); *Jones* v. *Commissioner,* 103 F. 2d 681, 684-685 (C. A. 9th); *Lauriston Inv. Co.* v. *Commissioner,* 89 F. 2d 327, 328 (C. A. 9th); *Royal Packing Co.* v. *Lucas,* 38 F. 2d 180, 181 (C. A. 9th); *Belser* v. *Commissioner,* 174 F. 2d 386, 389 (C. A. 4th), certiorari denied, 338 U. S. 893; *Hull's Estate* v. *Commissioner,* 124 F. 2d 503 (C. A. 2d), certiorari denied, 316 U. S. 690; *Reading Co.* v. *Commissioner,* 132 F. 2d 306 (C. A. 3d), certiorari denied, 318 U. S. 778; *Leicht* v. *Commissioner,* 137 F. 2d 433, 437 (C. A. 8th).

Since Central's sole assets at all times material here comprised the issued and outstanding shares of its two subsidiaries, Gas Fuel and Kettleman, taken over from Inland in 1936[5] (R. 180-181, 210, 394-395), it follows

[5] G. Brashears & Company was the top holding company of the several corporations involved herein, having acquired all the taxpayer's stock by the end of 1937. (R. 334-335, 398-399.) The taxpayer, in turn, owned the controlling interest in Central which

that whatever identifiable events occurred from time to time showing worthlessness of those shares up to 1941, inclusive, necessarily reflected worthlessness on or before December 31, 1941, of Central's shares owned by, and consequently of its indebtedness owed to, the taxpayer (R. 409). The Tax Court, upon carefully weighing all the evidence (R. 410), found a series of events specifically showing absence of either intrinsic or potential value and therefore complete worthlessness of the two items in question before or during 1941 (R. 394-405), and the facts, as found, fully sustain its ultimate finding that Central's indebtedness to and its stock owned by the taxpayer became worthless prior to January 1, 1942 (R. 406).

Facts specifically showing worthlessness of the two items prior to 1942 were found as follows: Kettleman's only gas well blew out early in 1935 thus depriving Gas Fuel of gas to supply its 10 or 12 customers. (R. 96, 299, 397.)[6] The serious financial difficulties by the end of 1935 of Inland, Gas Fuel and Kettleman—taken over by Central in 1936 (R. 394-395)—showed that their combined liabilities exceeded their assets by more than $58,000, and that their lands, leases and wells of a book value in excess of $1,100,000 were eliminated by quitclaims and abandonment as of December 31, 1935. (R. 283-285, 288-289, 398.) The reorganization plan in 1936, under which Central was created to take over and operate the business of Inland (R. 394-395), and whereby the taxpayer acquired an additional 1,050 of Central's shares, proved totally unsuccessful (R. 205-207, 210,

---

was created in 1936 to take over the assets and liabilities of Inland (dissolved in 1937), comprising all the issued and outstanding shares of Gas Fuel and Kettleman, Central's sole assets. (R. 29, 89-90, 210, 298-299, 304, 311, 318-320, 394-395, 399.)

[6] The record citations preceding page 391 refer to the evidence in support of these findings, showing absence of value and worthlessness of the two items in question prior to January 1, 1942.

298-299, 398-399, 400-403, 407-409; Pet. Br. 12). The taxpayer advanced large sums to Central during 1936 and 1937, and a final advance of only $50 in January, 1938, resulting in a net indebtedness, never paid, of $31,567.81 owed it by Central as of April 30, 1940. (R. 73-75.) This amount, however, the taxpayer, despite the absence of *anything* showing value after the end of 1940 (R. 359-361, 408-409), was not charged off as a loss by the taxpayer until December 31, 1942 (R. 399-400). Kettleman's attempts to bring in its own gas wells were unsuccessful (R. 101-107, 189-190), whereupon it obtained gas from another's well which was destroyed in May, 1937 (R. 103-104, 119-125). Thereafter, Gas Fuel contracted elsewhere for a gas supply (R. 104, 125-128), but the contract therefor was terminated less than four months later (November 11, 1937) by the vendor for non-payment of gas (R. 128-131), whereupon its gas distribution system supplying only about 10 customers ceased operating entirely (R. 128-129, 190, 400-401). All negotiations to revive Gas Fuel's business during 1937 and thereafter proved fruitless by the end of 1940, further attempts up to August, 1941, also having been unsuccessful. (R. 109-112, 164-174, 196-201, 213-214, 238-240, 402-403.) Gas Fuel requested in November, 1937, and was granted on January 3, 1938, by the California Railroad Commission permission to discontinue further services temporarily under circumstances found by the Commission showing gross inefficiency and waste in carrying on its business of distributing gas to its few customers, and on condition that it complete the repairs to its distributing lines and facilities as soon as possible. (R. 63-70, 401.) Gas Fuel, however, made no attempt to repair its gas distribution system, further damaged by floods in 1937 or 1938 (R. 133, 190-191), with the result that it sold all its assets in 1939 for a nominal amount (R. 193-194, 210-212), except its Certificate of

Public Convenience and Necessity (hereinafter called certificate) acquired in 1933, its sole remaining asset (R. 211, 299, 312, 401-402). After December 1, 1939, Kettleman was permanently without property of any kind (R. 75, 192-195, 211), and on or about January 6, 1940, and at all times thereafter its corporate charter and those of Central and Gas Fuel were suspended for failure to pay their state franchise taxes (R. 372-377, 379, 402).

The Tax Court found further that despite the promptings during 1938 to the early part of 1942, by the California Railroad Commission (R. 66-70, 140-141, 149-150, 153-154, 156-157, 160-162, 244-249), Gas Fuel and Central were unable to effect resumption of service to their customers as required by the conditions of the Certificate (R. 63-70, 398-403); and the Railroad Commission, upon being advised on June 9, 1942, that Gas Fuel had been inactive for three years and was no longer operating, revoked its certificate on October 6, 1942.[7] (R. 71-72, 249-250, 403-404). Upon certain of Central's stockholders' claiming that their stock therein became worthless in 1939, the local Internal Revenue Agent in Charge requested R. W. Moore in a letter dated November 22, 1940 (R. 208-209, 404), to furnish information covering "any event" which he considered rendered such stock worthless in 1939, Mr. Moore, as principal officer of Central, Gas Fuel and Kettleman, advised him in a letter dated December 2, 1940, that while the stock of the two latter subsidiary corporations had a book value in excess of $1,124,000, nevertheless the parent, Central,

---

[7] The Railroad Commission's formal order of revocation of Gas Fuel's certificate on October 6, 1942 (R. 71-72, 404), is the only factor occurring in that year to which the taxpayer can point in support of its contention that Central's stock and indebtedness in question continued to have potential value until they became worthless upon formal revocation of Gas Fuel's certificate in 1942 (R. 404). This is dealt with more fully hereinafter.

had no assets other than the stock of those subsidiaries; that the subsidiaries, in turn, had no assets of any nature except (R. 211) "the questionable value of its certificate of public necessity" which had value only commensurate with whatever profit Gas Fuel might be able to earn from its operations, all of which were then suspended; and that it was his personal opinion that all three corporations' (R. 212) "stock became practically worthless in the early part of 1939" (R. 210-212, 404). This was consistent with the information reported in the income tax returns of those three corporations which showed losses consistently for each of the years 1936 to 1939, inclusive, and each of their returns for 1940 reported that the corporation had been dormant for the previous two years, without transactions of any nature in 1940, and that the corporate franchise had been cancelled for non-payment of state franchise taxes in 1938.[8] (R. 404-405.)

Upon the basis of these findings, thus supported by substantial evidence of a long series of specific identifiable events showing complete worthlessness of the two items in question prior to 1942, the Tax Court found as an ultimate fact that (R. 406):

> The indebtedness of Central to petitioner and the stock owned by petitioner in Central became worthless prior to January 1, 1942.

It thereupon concluded as follows (R. 407, 408-410):

> We can not agree with petitioner. * * *
>
> * * * * *
>
> * * * at least by April 30, 1940 * * * the Central project was abandoned insofar as any additional investment of funds was concerned. * * *. One of the promoters of the project had already ex-

[8] The taxpayer's returns filed for the years 1936 to 1943, inclusive, of which those for 1942 and 1943 were consolidated returns, also showed losses for each year. (R. 394, 404-405.)

pressed the opinion in writing on December 2, 1940 that the stock of Central "became practically worthless in the early part of 1939." If the stock was practically worthless early in 1939 the indebtedness of Central to petitioner must have also been worthless. Certainly by the end of 1940 petitioner had nothing upon which to rely except the faint hope that some financial "angel" would purchase the certificate for at least $32,867.81 ($31,567.81 plus $1,300). We can not believe that the ordinary prudent man would have considered the indebtedness or the stock investment as having value at January 1, 1942. On this issue we affirm the respondent.

In so deciding we * * * base our decision upon the findings of fact * * * which were made after carefully weighing the evidence * * *.

These findings and conclusions, sustaining the Commissioner's determination, are entitled to finality unless "clearly erroneous". Rule 52 (a), Federal Rules of Civil Procedure;[9] *United States* v. *Gypsum Co.*, 333 U. S. 364, 394-395, rehearing denied, 333 U. S. 869; *Joe Balestrieri & Co.* v. *Commissioner*, 177 F. 2d 867, 873 (C.A. 9th); *Grace Bros.* v. *Commissioner*, 173 F. 2d 170, 173 (C.A. 9th); *Katz Underwear Co.* v. *United States*, 127 F. 2d 965 (C.A. 3d). The taxpayer has not shown that they are in any-wise erroneous. They should therefore "not be set aside" (Rule 52 (a), *supra*), a comprehensive review of the entire evidence of record failing to result in "the definite and firm conviction that a mistake has been committed" (*United States* v. *Gypsum Co., supra*, p. 395; *Grace Bros* v. *Commissioner*,

[9] Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869, which amended Section 1141 (a) of the Internal Revenue Code, provides that the Courts of Appeals shall have jurisdiction to review the decisions of the Tax Court in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury. *Joe Balestrieri & Co.* v. *Commissioner*, 177 F. 2d 867, 873 (C.A. 9th).

supra). Moreover, since the Tax Court's "findings are supported by the evidence", and "the taxpayer fails to present substantial evidence on every point necessary to entitle him to the deductions claimed, this Court * * * will hold against their allowance". *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 225 (C.A. 9th); *Belser* v. *Commissioner,* 174 F. 2d 386, 390 (C.A. 4th), certiorari denied, 338 U. S. 893.

In these circumstances, it is plain that there were many identifiable events demonstrating that both the stock and the indebtedness in question were utterly worthless at least after December 31, 1939, and in any event at the end of 1941. This is true unless the taxpayer can show that Gas Fuel could obtain a gas supply and the necessary finances with which to construct a new gas distribution system to serve its customers, and thereby utilize its certificate claimed as being potentially valuable. As shown, however, the facts establish the contrary, and that the probability of such results after 1939 was entirely too remote and speculative to be relied upon as giving any value, potential or otherwise, to Gas Fuel's certificate and, in turn, to the taxpayer's stock and debt on or before December 31, 1941, much less thereafter. (R. 359-361.) The taxpayer was advised in a letter from its own certified public accountants, Thomas & Moore (R. 310-313), that as early as February 4, 1941, "The Investment [in the stock of Central] is of doubtful value" (R. 312). Moreover, the facts show that Central and its two wholly-owned subsidiaries were hopelessly insolvent as early as 1939, and in any event long before 1941 (R. 397-406), and therefore there was no value whatever left in Gas Fuel's certificate or in the taxpayer's shares and indebtedness of Central by January 1, 1942. Sections 29.23 (e)-1 and 29.23 (k)-1 of Treasury Regulations 111 (Appendix, *infra*). Accordingly, it is clear that the stock

and consequently the indebtedness in question became totally worthless before December 31, 1941 (R. 409), and that therefore the aggregate amount thereof may not properly be considered a net operating loss sustained during 1942, under the provisions of the pertinent statute and Regulations (Section 23 (f) and (k) (1) of the Internal Revenue Code; Sections 29.23 (e)-1 and 29.23 (f)-1 of Treasury Regulations 111 (Appendix, *infra*)), which may be carried forward and deducted for the taxable year 1943, under the provisions of Section 122 (a) and (b) (2) of the Code.

It is settled that a taxpayer may not select the year in which he will claim his loss deduction; he must claim it for the year in which it was actually sustained and not for some other year when the deduction may be more advantageous. *Lucas* v. *American Code Co.*, 280 U. S. 445; *Belser* v. *Commissioner, supra,* p. 390; *Mahler* v. *Commissioner,* 119 F. 2d 869 (C. A. 2d), certiorari denied, 314 U. S. 660; cf. *DeLoss* v. *Commissioner,* 28 F. 2d 803, 804 (C. A. 2d), certiorari denied, 279 U. S. 840. It has been held that a taxpayer may not close his eyes to the obvious and thereby attempt to take a loss deduction for worthless stock or a bad debt for a year subsequent to that in which it became worthless. *Hirsch* v. *Commissioner,* 124 F. 2d 24, 31 (C. A. 9th); *Mahler* v. *Commissioner, supra; Darling* v. *Commissioner,* 49 F. 2d 111 (C. A. 4th), certiorari denied, 283 U. S. 866. Moreover, a taxpayer may not, for business reasons or through friendly motives fail to attempt timely to recoup his losses from a defaulter, as here, so that the loss may occur in a later year of larger income when it would be more advantageous. *Person Const. Co.* v. *Commissioner,* 116 F. 2d 94, 95 (C. A. 7th); *H. D. Lee Mercantile Co.* v. *Commissioner,* 79 F. 2d 391, 393 (C. A. 10th). The exercise of a tax-

payer's own judgment as to when he will effect and take his deduction usually "results in the loss falling in the year of his largest income—seldom if ever in the year when the operation of his business resulted in a loss." *Person Const. Co.* v. *Commissioner, supra,* p. 95. The correst test was stated in *United States* v. *White Dental Co.,* 274 U. S. 398, 401, 403, as follows:

> The statute obviously does not contemplate and the regulations (Art. 144) forbid the deduction of losses resulting from the mere fluctuation in value of property owned by the taxpayer. * * * But with equal certainty they do contemplate the deduction from gross income of losses, which are fixed by identifiable events, such as the sale of property * * * or, in the case of debts, by the occurrence of such events as prevent their collection (Art. 151).
>
> * * * * *
>
> The Taxing Act does not require the taxpayer to be an incorrigible optimist.

We have shown here a series of identifiable events fixing worthlessness of the two items in question long before the year 1942, and a fact picture indicating knowledge on the part of the taxpayer of such worthlessness during that time. As stated in *Boehm* v. *Commissioner,* 326 U. S. 287, 292:

> Such an issue of necessity requires a practical approach, all pertinent facts and circumstances being open to inspection and consideration regardless of their objective or subjective nature. * * *

As against the foregoing showing of complete worthlessness of the two items in question prior to 1942, the taxpayer contends, substantially as it did in the Tax Court (R. 406-407), that Gas Fuel's single remaining asset, the certificate, had potential value—which, in

turn, gave value to Central's stock and indebtedness in question—until revocation of the certificate on October 6, 1942, and that *that* was the identifiable event which completely extinguished all value and fixed worthlessness of the two items in question in that year (Br. 24-25, 29-32, 50-51). It claims, incongruously, that none of the following salient facts support the Tax Court's finding of worthlessness prior to January 1, 1942—the taxpayer's furnishing capital to other enterprises at the same time and long after it had ceased making further advances to Central (Br. 25-28), the sale of all the assets of Gas Fuel and Kettleman in 1939 (Br. 29-32), the suspension of the corporate charters of Central, Gas Fuel and Kettleman on January 6, 1940 (Br. 33-34), the letter of December 2, 1940, to the Revenue Agent from Ralph W. Moore, the principal officer of those three corporations, giving his opinion that the subsidiaries' stock became worthless early in 1939, as claimed by certain stockholders of Central (Br. 34-38), and the failure of all negotiations to dispose of Gas Fuel's certificate by the end of 1940 (Br. 38-39). In these circumstances, the taxpayer states that the Tax Court failed to apply the correct principles of law in making its decision. (Br. 40-49.)

These contentions are untenable, and in no wise refute the Tax Court's findings. We have shown that the two items in question, claimed as losses sustained in 1942, plainly became worthless prior thereto. Moreover, it is clear that the revocation of Gas Fuel's certificate in 1942 could not have been, as alleged by taxpayer, the identifiable event which determined and fixed the time of worthlessness. The facts show that the certificate had become worthless in the hands of its possessor long before 1942. The certificate could have had no greater value than its demonstrated ability to produce earnings, which were practically nil at the end

of 1937 (R. 400-401), and totally so at the end of 1939 (R. 403-404). It was of such character as to be granted only by the State according to the needs of the community and the ability of the applicant to fulfill them, and was therefore clearly not negotiable or saleable by its possessor. Consequently, it must necessarily have been wholly devoid of monetary or even potential value so long as Gas Fuel was, as the facts show, without a gas supply, or the possibility of getting such supply as well as the necessary financial aid to construct a new gas distributing system, and therefore unable to make any use of it at any time after 1939. (R. 398-404.) The taxpayer admits that it "*never* had at its disposal funds in the amount that would have been necessary to develop a [new] gas utility system on the scale" requisite to revive Gas Fuel's business in order to serve its customers, and thereby utilize its certificate. (Br. 26.) In harmony therewith, it states that "Petitioner's capital resources were decidedly limited, and thus petitioner could not materially alter the [defunct] status of Central". (Br. 26-27.) This indeed shows absence of potential value in the certificate.

There is further evidence showing lack of potential value in Gas Fuel's certificate prior to January 1, 1942. Thus, the taxpayer's expert witness Bauer testified on cross-examination that under the circumstances here Gas Fuel's certificate would have "little or no value" as of the end of 1939, 1940 or 1941, and that the potential value thereof during the three-year period 1939-1941 would have depended on the possibility of the certificate holder's making a factual showing—absent here—that it would be able to obtain a gas supply and a new distributing system.[10] (R. 359-361.) Witness

[10] Witness Bauer's testimony that Gas Fuel's certificate had potential value as of January 1, 1942, was based on the *assumption* that Gas Fuel had a source of gas supply at prices and in quan-

Ralph W. Moore's testimony as to value, moreover, was a series of contradictions. Thus, he testified that he was of the opinion that the stock here in question had at all times "substantial value to somewhere along in March or April * * * in 1942". (R. 205.) In refutation thereof, it is necessary merely to refer to his letter of December 2, 1940, to the Internal Revenue Agent in direct contrariety thereto. (R. 210-212, 404.) There he gave his appraisal of the stock, assets (including Gas Fuel's certificate), and probabilities of the successful operation of Central and its two subsidiaries, stating that, as principal officer of Central, Gas Fuel and Kettleman, it was his opinion that Gas Fuel's certificate was of "questionable value", dependent upon its ability to earn profits from operations, all of which had been suspended, and that the stock of the three corporations, including Central, became "practically worthless"[11] in the early part of 1939. (R. 211, 212, 224, 228, 404.) This was in reply to the Revenue Agent's letter of November 22, 1940,

---

tities which would have been profitable for re-sale purposes as of that date, and that there would be a possibility that it could also raise the necessary funds through public or private financing with which to build a new gas distributing system as of January 1, 1942 (R. 340-344); but that it would not have such value if, as shown, Gas Fuel had no such source of supply and possibility of financial assistance (R. 345-349). Moreover, witness Bauer admitted that he knew nothing about the operation of Gas Fuel with respect to the utilization of its certificate, or as to the conditions prevailing at any time with respect to its prospects of obtaining a gas supply or financial aid necessary to construct a new gas distributing system. Hence, having no knowledge of the facts of record, he was obliged to testify on the basis of assumed facts. (R. 355-357, 361-362.)

[11] Witness Moore, in explanation of what he meant by the use of the words "practically worthless" in the letter to the Revenue Agent, testified that "My use of that word was based upon the asset values shown in the balance sheet and on the books [of Central, Gas Fuel and Kettleman]. The stock as a stock certificate was practically worthless at that time" [early 1939]. (R. 224, 228.) The record shows that the asset values of the three corporations were nil at that time. (R. 400-402.)

advising him that Central's stockholders were then claiming that its stock became worthless in 1939, and requesting that he furnish information covering "any event which in your opinion rendered the stock worthless." (R. 208-209, 404.) Moreover, witness Moore having previously testified that he first found out in March or April, 1942, that it would be impossible to obtain a gas supply for Gas Fuel (R. 206), later contradicted this statement. Thus, he testified, in reply to the question as to how long he had had "honest hopes of getting gas production back into operation", that "the date would be in '41." (R. 220.) It is settled that the Tax Court is not bound by such testimony, whether or not uncontradicted, and particularly that of an interested witness, as here. *Sartor* v. *Arkansas Gas Corp.*, 321 U. S. 620, 627-628; *Quock Ting* v. *United States*, 140 U. S. 417, 420-421; *Joe Balestrieri & Co.* v. *Commissioner*, 177 F. 2d 867, 873-875 (C. A. 9th); *Grace Bros.* v. *Commissioner*, 173 F. 2d 170, 174 (C. A. 9th); *Spero-Nelson* v. *Brown*, 175 F. 2d 86, 90 (C. A. 6th); *Friend* v. *Commissioner*, 102 F. 2d 153 (C. A. 7th).

Furthermore, witness Moore's failure to disclose all the facts—in respect to Gas Fuel's non-compliance with the requirements and conditions of the certificate—in his correspondence with the California Railroad Commission during the period 1939-1941 (R. 140-164, 403), demonstrates quite plainly, by implication at least, the unreliability of his testimony with respect to the alleged potential value of Gas Fuel's certificate. Thus he failed to reveal in the letters to the Commission the facts in respect of Gas Fuel's disposition of its distributing system, suspension of its charter, loss and impossibility of regaining its gas supply, and discontinuance of its operations requisite under the certificate, blaming the cessation of Gas Fuel's activities entirely on floods occurring in 1937 or 1938, because of which its

customers, he stated, allegedly demanded no gas supply and would not need it until the spring of 1941. (R. 142, 151, 155, 158-159, 163-164, 403, 407-408.) In these circumstances, witness Moore's "Silence then becomes evidence of the most convincing character." *Interstate Circuit* v. *United States,* 306 U. S. 208, 226.

Finally, it is clear that Gas Fuel's certificate had no real or potential value after the suspension of Central's and its subsidiaries' charters, including Gas Fuel's, on January 6, 1940. (R. 402.) Thereafter, all those corporations and their officers, directors and stockholders were precluded by local law from borrowing money by note or otherwise, accepting subscriptions for or selling stock, and carrying on any further operations or business of any nature. Section 32, California Bank and Corporation Franchise Tax Act (Appendix, *infra*); *Silvey* v. *Fink,* 99 Cal. App. 528, 531-532, 279 Pac. 202, 203-204; *Van Landingham* v. *United Tuna Packers,* 189 Cal. 353, 362-372, 208 Pac. 973, 976-980. Hence, in the absence of payment of all taxes, interest, penalties, etc., and the possible issuance of a certificate of revivor (Section 33, California Bank and Corporation Franchise Tax Act (3 Deering's General Laws, Act 8488); Pet. Br. 4-5), no use whatever could be made of Gas Fuel's certificate. Any subsequent revival of their corporate rights would not have had the effect of validating their acts attempted during the period of suspension for a certificate of revivor, if issued, is not made retroactive by the statute. Section 33, California Bank and Corporation Franchise Tax Act; *Van Landingham* v. *United Tuna Packers, supra,* p. 369; *Ransome-Crummey Co.* v. *Superior Court,* 188 Cal. 393, 396-397, 205 Pac. 446, 448. Hence, there was no real or potential value inherent in Gas Fuel's certificate after suspension of its charter in 1940. Central and its subsidiaries, of course, could not use it thereafter, and there was little,

if any, likelihood that third parties would have been interested in acquiring it from *them,* even assuming that they could do so. It was admittedly obtainable, without cost, only from the Railroad Commission; hence, third parties would not have been apt to put themselves in the position of acquiring it from Central or its subsidiary, Gas Fuel, whose officers, directors and stockholders would have been unable to consummate the deal, and would have subjected themselves to criminal action if they had performed any of the prohibited acts. Section 32 (a), California Bank and Corporation Franchise Tax Act; *Van Landingham* v. *United Tuna Packers, supra,* pp. 370-372; *Ransome-Crummey Co.* v. *Superior Court, supra,* pp. 396-397. In these circumstances, since the certificate was not saleable, the suspended corporation was precluded under penalty of law from selling it, and Gas Fuel did not have, could not and was not allowed by law to obtain the funds necessary to make use of it (*Silvey* v. *Fink, supra,* pp. 531-532), as required by the certificate (R. 49-62, 63-70, 401). It must be considered, therefore, for all practical as well as tax purposes, to have been without value, potential or otherwise, after 1937 or 1939 at the latest, and in any event prior to 1942 (R. 400-404, 406, 407-409).

In these circumstances, it is quite apparent that Central and its subsidiaries had not only ceased operations and abandoned the assets of the latter (R. 398, 400-402), but also had, in effect, abandoned Gas Fuel's certificate. Just as the subsidiaries had abandoned all their lands, leases and wells as of the end of 1935 (R. 398), so Gas Fuel—having lost its contract for gas supply and ceased all operations after November 11, 1937 (R. 400-401), become totally inactive after June 30, 1939 (R. 72, 249, 403-404), lost its corporate charter by suspension on January 6, 1940 (R. 402), and having no possible further use or *useability under local law* for its certificate—

had, in effect, abandoned the certificate to all intents and purposes long before it was *formally* revoked in 1942. It could have been revoked for noncompliance with its requirements at any time after 1939 (R. 49-51, 397, 408-409), and Gas Fuel's total noncompliance after November 11, 1937, was indeed tantamount to complete abandonment. Further support is given to this conclusion by the letter of March 17, 1941, from the Railroad Commission to Central stating that its engineer, Crenshaw, had discussed the situation with the officers of Central and Gas Fuel on March 4, 1941, and had been advised that it was their (R. 160) "intention to permanently abandon gas service"—and, therefore, by inference, also the certificate at that time (R. 160-162, 403); and also by Gas Fuel's letter of June 9, 1942, to the Commission stating that it was no longer operating and had been inactive for three years prior thereto (R. 249-250, 403-404). Moreover, as heretofore shown, since Central and Gas Fuel were specifically precluded by law from using or even attempting to raise funds to make use of the certificate during Gas Fuel's corporate charter suspension, extant since January 6, 1940 (R. 402), it was necessarily not *useable* thereafter under any circumstances (*Van Landingham* v. *United Tuna Packers, supra; Silvey* v. *Fink, supra; Ransome-Crummey Co.* v. *Superior Court, supra*), and therefore without any value since that time, regardless of when the certificate was *formally* revoked.

Since the present case turns on its own facts, as the taxpayer admits (Br. 19), the many cases cited by it (Br. 19-20, 22-24, 28-29, 42-49) which involve different factual situations need not be discussed. Precedents involving distinctive facts are of no great value. *American Trust Co.* v. *Commissioner,* 31 F. 2d 47, 49 (C.A. 9th). The taxpayer has cited no case containing the same or similar factual situation involved here.

CONCLUSION

The decision of the Tax Court is correct, and should therefore be affirmed upon review by this Court.

Respectfully submitted.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
ROBERT N. ANDERSON,
S. DEE HANSON,
Special Assistants to the Attorney General.

FEBRUARY, 1950.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.* — In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

(g) *Capital Losses.*—

* * * * *

(2) *Securities becoming worthless.*—If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) *Definition of securities.*—As used in this subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) [As added by Sec. 123 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Stock in affiliated corporation.*—For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. * * *

* * * * *

(k) [As amended by Sec. 113 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General Rule.* — Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the

Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 122 [As added by Sec. 211 (b) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and amended by Sec. 153 (a) of the Revenue Act of 1942, *supra*] NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

* * * * *

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4) and (6), and computed by determining

the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

California Bank and Corporation Franchise Tax Act (3 Deering's General Laws, Act 8488):

Section 32. *Suspension and forfeiture of corporate powers.*

(a) [*Powers, rights and privileges of delinquent corporation to be suspended or forfeited.*] If any tax, or any portion thereof, together with penalties, and interest thereon, which is due and payable either at the time the return is required to be filed or on or before the fifteenth day of the ninth month following the close of the income year, is not paid on or before six o'clock p.m. on the last day of the twelfth month after the close of the income year or if any tax due and payable upon notice and demand from the commissioner, together with penalties and interest thereon, is not paid on or before six o'clock p.m. on the last day of the eleventh month following the due date of such tax, except in case of jeopardy or fraud assessments, in which case, if such tax, interest and penalties are not paid within 40 days from the date such tax, penalties and interest are due and payable (unless the bond required by this act is filed to stay the collection of such tax, penalties and interest and such tax, interest and penalties are paid within 60 days after notice by the commissioner on taxpayer's petition for reassessment), the corporate powers, rights and privileges of the delinquent taxpayer, if it be a domestic bank or corporation, shall be suspended and shall be incapable of being exercised for any purpose or in any manner except for the purpose of amending the articles of incorporation to set forth a new name; if the delinquent taxpayer be a foreign bank or corporation the right to exercise

its corporate powers, rights and privileges in this State shall be forfeited.

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23 (e)-1. *Losses by Individuals.*—* * *

* * * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. * * *

* * * * *

SEC. 29.23 (f)-1. *Losses by Corporations.*—Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible in so far as not prohibited or limited by sections 23 (g), 23 (h), 24 (b), 112, 117, 118, and 251. The provisions of sections 29.23 (e)-1 to 29.23 (e)-5, inclusive, and section 29.23 (i)-1 are in general applicable to corporations as well as individuals. * * *

SEC. 29.23 (g)-1 [As amended by T. D. 5458, 1945 Cum. Bull. 45] *Capital Losses.*—Section 23 (g) provides in effect that deductions allowed to individuals under section 23 (e) and to corporations under section 23 (f) for losses sustained on the sale or exchange of a capital asset shall be limited in amount to the extent provided in section 117. Losses sustained by virtue of securities becoming worthless during the taxable year are, under section 23 (g), made subject to the limitations provided in section 117 with respect to sales or exchanges, provided the securities are "capital assets" as that term is defined in section 117 (a) (1). For purposes of computing the net income of any taxpayer, such losses are to be considered as being sustained from the sale or exchange of the securities on the last

day of the taxable year, irrespective of when during the taxable year such securities actually became worthless. Section 23 (g) does not apply to securities which are deemed destroyed or seized under section 127, relating to war losses.

As used in section 23 (g) and this section the term "securities" means shares of stock in a domestic or foreign corporation and rights to subscribe for or to receive such shares.

* * * * *

SEC. 29.23 (k)-1 [As amended by T. D. 5376, 1944 Cum. Bull. 119]. *Bad Debts.*—(*a*) Bad debts may be treated in either of two ways—

(1) By a deduction from income in respect of debts which become worthless in whole or in part, or

* * * * *

(*b*) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless, to the extent charged off during the taxable year, shall be allowed as a deduction in computing net income. If a taxpayer claims a deduction for a part of a debt for the taxable year within which such part of the debt is charged off and such deduction is disallowed for such year and the debt becomes partially worthless subsequent to such year, a deduction may be allowed for a subsequent taxable year, not in excess of the amount charged off in the prior year plus any amount charged off in the subsequent year, the charge-off in the prior year, if consistently maintained as such, being sufficient to that extent to meet the charge-off requirement. Before a taxpayer may deduct a debt in part, he must be able to demonstrate to the satisfaction of the Commissioner the amount thereof which is uncollectible and the part thereof which was charged off. If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. * * *. In determining

whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. * * *.

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. * * *

* * * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1950 872939 474